

8. This statement mischaracterizes our analysis of industry conditions and the likely consequences of the proposed transaction. We do not dispute that there have been significant changes in competitive circumstances in the long distance industry, including the emergence of new networks and the growth of fringe long distance carriers. The development of these “emerging networks” and fringe carriers was highlighted in our analysis supporting the merger of MCI and WorldCom. That merger did not raise significant competitive issues precisely because of the emergence of new networks, several of which were (correctly) projected at that time to become as broad in scope as WorldCom’s network at the time of its merger with MCI.

9. This proposed merger, however, differs from the MCI/WorldCom transaction because it combines two of only three “brand-name” providers of long distance services. In contrast to Sprint, WorldCom accounted for a negligible share of residential consumers at the time of its MCI transaction and did not have a widely recognized brand name. Available evidence indicates that the emergence of new networks is insufficient to prevent a diminution in residential competition as a result of the proposed transaction. As discussed in our initial declaration and in additional detail below, the provision of long distance services to residential customers is not competitive today and brand recognition appears to be a significant impediment to the expansion of fringe suppliers of residential services. As we discussed in our initial declaration (¶¶47-48), while the entry of RBOCs into the provision of long distance service will bring significant new brand-name competitors to the market, the timing and magnitude of their entry remains highly uncertain.

10. Drs. Besen and Brenner (p. 3) argue that our claims “are inconsistent with the observed ability of the emerging carriers to capture residential and small business customers.” The implications of their arguments on the ability of fringe suppliers to discipline competition, however, are so far reaching as to be absurd. For example, their arguments imply that a merger of AT&T, which still accounts for more than half of residential customers, and MCI WorldCom would not harm competition. Their arguments even imply that a merger of all three brand-name suppliers would not raise competitive concerns.

11. Drs. Besen and Brenner overstate the ability of emerging carriers and fringe suppliers to constrain pricing to mass market consumers today and in the near future. While several new networks are being deployed, this will not prevent potential adverse effects of the proposed transaction on competition at the retail level. As discussed in our prior declaration, brand name is an important aspect of competition in the provision of service to mass market customers, and the new carriers do not have significant brand names.

12. A 1999 consumer survey provides striking additional evidence of consumers' lack of awareness of brand names of fringe long distance carriers. In response to requests for consumers' "unaided recall" of the names of long distance carriers, nearly 90 percent of survey respondents identified AT&T and more than 60 percent identified MCI and Sprint. Excel, the largest fringe long distance supplier, was identified by less than 3 percent of respondents. Excel was identified more frequently than any other fringe carrier. Several RBOCs, which do not provide interexchange services, were identified as long distance carriers more frequently than Excel.⁷

13. Drs. Besen and Brenner also criticize our analysis of consumer preference for brand name suppliers for focussing on AT&T customers. However, AT&T's brand name and large share of residential customers make it of direct relevance in analyzing the behavior of mass market consumers. Drs. Besen and Brenner do not dispute that the data we report suggest that a large share of residential consumers have strong preferences for brand name long distance providers and fail to take advantage of lower priced service offerings. Nonetheless, in response to their comments, we have calculated the share of MCI WorldCom and Sprint customers that, based on their calling pattern, would obtain lower prices from fringe carriers Excel, Frontier and Qwest (in the manner we did for AT&T customers in our prior

7. IDC, Branded! Residential Telecommunications Brand Image Assessment, 1999, September 1999, Table 4.

declaration). The results indicate that roughly two-thirds of MCI WorldCom customers and more than half of Sprint customers would face better rates from one of these three fringe carriers.

14. There also is no merit to the suggestion by Drs. Besen and Brenner that our analysis indicating that a large number of AT&T customers could obtain lower prices from another AT&T calling plan is unreliable because “[t]here is considerable seasonality in residential calling patterns, and average minutes calling per household during these months, especially in December, were relatively high.”⁸ In response to this comment, we have extended our prior analysis, which was based on data from 1998Q4 alone, to also include data from 1998Q3. Results based on this longer time period indicate that 74 percent of basic rate customers could obtain lower prices from another AT&T plan (compared to 78 percent based on 1998Q4 data alone). The results for 1998Q3-Q4 also indicate that 44 percent of “One Rate” customers would obtain lower prices from another AT&T plan and that 34 percent of “One Rate Plus” customers could obtain lower prices under another plan.^{9, 10}

III. THE GROWTH OF FRINGE LONG DISTANCE SUPPLIERS HAS NOT CONSTRAINED LONG DISTANCE PRICING

15. As noted above, Drs. Besen and Brenner report that “by 1997 the emerging carriers collectively had a larger share of residential long distance business than either Sprint or MCI. [...] Moreover, individual emerging carriers have shown an ability to gain share rapidly over relatively short periods.”¹¹ They conclude that the “ability of emerging carriers to increase their market share steadily in a competitive marketplace bodes well for their ability to attract

8. Besen and Brenner, ¶134.

9. The corresponding figures reported in our earlier declaration based on 1998Q4 alone were 43 percent and 46 percent respectively.

10. Drs. Besen and Brenner (¶19) also criticize this analysis for “not [taking] into account special promotions and offers.” This criticism also is unwarranted. Any special offers and promotions would be relevant only for new and not existing customers. The approach we undertook in this analysis is very similar that used by the FCC in analyzing trends in prices for “price sensitive” consumers. (See ¶18 below.)

11. Besen and Brenner, p. 15.

customers should a merged MCI WorldCom-Sprint attempt to exercise market power.”¹² The reply comments submitted by Applicants go further, claiming that “the competitiveness of the mass market long distance market is proven by its performance.”¹³ Applicants claim that “[t]he Commission’s Millennium Report issued only last month further confirms the dramatic decreases in prices for long distance.”

16. Neither claim is supported by available evidence. As a preliminary matter, it is important to note that Applicants’ claim is not even supported by the data they cite.

- First, Sprint and MCI WorldCom cite data on changes in average long distance revenue per minute. These data include revenue from business as well as residential customers and include revenue from both domestic and international calls. The data do not include any adjustment for changes over time in access fees.
- Second, Sprint and MCI WorldCom cite changes in the CPI for residential telephone services. Again, the CPI data include no adjustment for changes over time in access fees.

As such, these data provide no support for Sprint and MCI WorldCom’s claim that residential long distance services have become more competitive, which implies that prices to residential consumers have fallen by more than the reduction in access fees.

17. Moreover, available evidence contradicts the claim by Drs. Besen and Brenner that fringe carriers constrain pricing by branded carriers. Instead, the data presented below show that: (i) long distance rates net of access costs charged by AT&T to residential customers have not fallen but have increased over time; and (ii) long distance rates charged by AT&T to residential customers appear to be above costs, as roughly approximated by prices available from firms that resell long distance service provided by others. These data suggest that rates for mass market long distance consumers are not yet at competitive levels. Given the

12. Besen and Brenner, p. 14.

13. Reply to Comments and Petitions to Deny Application For Consent to Transfer Control, March 20,2000, pp. 30-31.

importance of brand name, and evidence suggesting that such prices are not at competitive levels, regulators must be more vigilant about mergers among branded long distance carriers.¹⁴

Changes in AT&T rates over time

18. Available data indicate that rates received by AT&T net of access charges have risen in recent years, especially among low-volume users. Table 1 reports data from the FCC on the average revenue per minute earned by AT&T for "price sensitive residential callers" for January 1991, February 1997 and November 1998, the most recent data available. These data, which are compiled by the FCC, reflect the lowest rate available from AT&T for subscribers with particular calling patterns.¹⁵ We have calculated the average access fees faced by AT&T subscribers with various minutes of use per month and report in Table 1 AT&T's average revenue net of access for residential service.¹⁶ Our calculations of average access fees are attached as Appendix I.

14. The analysis presented in the declaration by Prof. Jerry Hausman on behalf of SBC presents econometric evidence that fringe suppliers do not constrain pricing by the three major long distance carriers.

15. FCC Reference Book on Rates, Prices Indices and Expenditures for Telephone Service, p. 46 and Table 2.4. The FCC calculates rates paid by "price sensitive" customers by evaluating the available AT&T calling plan that offers the lowest cost of service based on individual consumers' calling patterns (e.g., the number of calls made by time of day, day of week and destination). Since calling patterns vary across consumers, the best plan for different consumers can vary. The FCC then evaluates changes over time in the average "best available rate" (defined in this manner) for groups of consumers based on aggregate number of calling minutes per month.

16. Over this period, a variety of changes occurred in access and related fees paid by AT&T and other long distance carriers to local exchange carriers. Per minute access charges fell from \$0.0604 per minute to \$0.0382 per minute from February 1997 to November 1998. In January 1998, the FCC imposed a presubscribed interexchange carrier charge of \$0.49 per month. At the same time, the FCC eliminated its fixed universal service fund contribution of \$0.53 per month and instituted a variable charge of 3.9 percent of interstate and international revenues to cover this obligation.

Table 1

**Average Charge Net of Access for Price Sensitive Residential Callers
Based on AT&T Tariffs**

Date	30 Minutes or Less		50 to 70 Minutes		110 to 130 Minutes		270 to 330 Minutes		500 Minutes or More	
	Billed	Net	Billed	Net	Billed	Net	Billed	Net	Billed	Net
January-1991	0.1641	0.0704	0.1530	0.0630	0.1464	0.0600	0.1446	0.0717	0.1428	0.0705
February-1997	0.1499	0.0537	0.1387	0.0590	0.1257	0.0516	0.1206	0.0584	0.1140	0.0527
November-1998	0.3691	0.2837	0.1518	0.0861	0.1293	0.0712	0.1103	0.0705	0.1002	0.0612
Median Minutes		15		60		120		300		600
Percentage Change, 1997-98	146.2%	428.4%	9.4%	46.1%	2.9%	37.8%	-8.5%	20.6%	-12.1%	16.1%
Percentage Change, 1991-98	124.9%	303.2%	-0.8%	36.6%	-11.7%	18.6%	-23.7%	-1.7%	-29.8%	-13.2%

Source: FCC, "Reference Book of Rates, Price Indices and Expenditures for Telephone Service", Table 2.4.

Note: Billed figures reported by FCC, Net figures calculated based on access charges in effect evaluated at median minutes of usage.

19. Between February 1997 and November 1998, a period when Drs. Besen and Brenner claim that fringe suppliers were serving a significant share of residential subscribers, average revenue per minute (net of access charges) charged by AT&T for its best available rate rose for both high-volume and low-volume categories. The increase among low-volume customers was especially large, increasing by more than 52 percent for customers with 60 minutes of use per month. These increases largely reflect the imposition by AT&T of minimum charges for new residential customers in August 1998.¹⁷

20. Available data suggest that, even over longer time periods, average net-of-access charge rates available from AT&T to residential consumers have fallen only for high-volume subscribers. For example, among subscribers with 120 minutes of use, the net of access charge rate offered by AT&T increased by 19 percent from January 1991 to November 1998. (Data from PNR from 1998 indicate that more than 80 percent of residential subscribers have under 120 minutes of use per month.)

21. Even though Applicants claim that the market for residential long distance services is competitive, we are aware of no evidence put forward by Applicants or others suggesting that AT&T faced increases in marginal costs over this period that explain this price increase. Indeed, Applicants have claimed that long distance suppliers have been facing declining costs in recent years.¹⁸

Rates Offered by AT&T and Fringe Suppliers

22. Moreover, pricing offered by fringe suppliers suggests that these changes in long distance prices over time do not reflect a move from an unsustainable, subsidized level to a competitive level. For example, a variety of resellers and dial-around long distance companies offer rates that are well below those charged by AT&T. To cite just two examples:

17. AT&T also introduced minimum monthly fees for its basic-rate customers in April 1999.

18. Application, p. 14.

- Bell Atlantic, which recently entered into the provision of long distance service in New York as a reseller, offers rates of \$.09 per minute and \$.05 per minute on weekends with no minimum monthly fee.¹⁹
- Similarly, Var-Tec's 10-10-636 dial-around service charges \$.05 per minute with a minimum of \$.15 per call with no minimum monthly fee.²⁰

23. Since resellers typically purchase service on a wholesale basis from other carriers, the prices these firms charge can be taken as a conservative estimate of the costs faced by large carriers for providing long distance service, even for low-volume customers. If so, then the data in Table 1 indicate that average revenue earned by AT&T is well above the marginal cost of providing service for both low-volume as well as high volume residential customers.²¹

24. In sum, the increase in AT&T revenue net-of-access charges over this period (over and above any changes in costs) and pricing of services at what appear to be above-cost rates suggest that long distance prices today are not yet at competitive levels and that, in contrast to claims by Drs. Besen and Brenner, the growth of fringe suppliers has not constrained AT&T pricing over this period. Thus, these data are inconsistent with the claim by Drs. Besen and Brenner that the presence of fringe suppliers ensures that prices would not increase following the proposed merger.

IV. DRS. BESEN AND BRENNER'S ANALYSIS OF CONSUMERS' WILLINGNESS TO USE FRINGE SUPPLIERS IS BASED ON FLAWED ASSUMPTIONS

25. Our February declaration presented data on the extent of customer turnover, or "churn," faced by long distance suppliers and data on the frequency with which subscribers switch between suppliers.²² That analysis, based on data from Paragren Technologies from

19. <http://www.callbell.com/evaluates/exclusiveonlineoffer.htm>

20. [wysiwyg://69/http://www.clearchoice.net/FlashSite/index_flash.html](http://www.wysiwyg.com/69/http://www.clearchoice.net/FlashSite/index_flash.html)

21. Similarly, the analysis presented in our initial declaration indicates that facilities based fringe suppliers offer services that are substantially lower in price than those offered by AT&T.

22. "Churn rates" reflect the proportion of a long distance supplier's customers lost in a given

October 1998 to September 1999, indicated that Sprint and MCI WorldCom face higher churn rates than AT&T and that MCI and Sprint are closer substitutes than either firm is with AT&T, or with fringe carriers. We concluded that these data were consistent with available evidence indicating that Sprint and MCI had greater incentives than AT&T to introduce pricing and service innovations and that a merger between Sprint and MCI WorldCom would be expected to have more adverse consequences than implied by their market shares alone.²³

26. Drs. Besen and Brenner also use data from Paragren Technologies in order to analyze customer churn among long distance suppliers and to evaluate the willingness of residential consumers to use services provided by fringe long distance suppliers. Drs. Besen and Brenner, however, depart from the approach used by Paragren Technologies in defining customer switching behavior. Paragren measures customer churn based on changes in a customer's presubscribed interexchange carrier, and our analysis maintains this approach. As discussed below, the modified approach used by Drs. Besen and Brenner fail to distinguish short-term consumer experimentation with dial-around providers with longer-term decisions regarding choice of presubscribed long distance carrier.

27. Drs. Besen and Brenner do not dispute the finding from our initial declaration that MCI WorldCom and Sprint face higher customer turnover than AT&T.²⁴ As we had discussed, these circumstances imply that the three branded long distance providers do not face identical demand conditions and, as a result, have diverse incentives to cut price, and to develop and promote new service offerings. More specifically, the data indicate that Sprint and MCI WorldCom customers switch more often than AT&T customers and that MCI and Sprint each continuously need to attract a relatively larger number of customers than AT&T merely to replace those lost to rivals.

(...continued)
month.

23. See ¶¶32-38 of our February declaration.

24. Indeed, Drs. Besen and Brenner acknowledge (p. 25) that "AT&T customer base erodes somewhat less rapidly" than that of MCI WorldCom and Sprint."

28. In their attempt to rebut our analysis, however, Drs. Besen and Brenner depart from the approach to measuring churn used by Paragren Technologies, the source of the data they utilized, and attempt to define customer turnover based on a household's "main vendor" for long distance services. They describe their methodology as follows:

... A household's main vendor is defined as the carrier the household uses to carry the largest number of minutes of interLATA direct dialed domestic calling in that month. A household's main vendor is not necessarily its presubscribed carrier because households can use dial around services for the majority of their calls, and some households do just that. Many emerging carriers have chosen to market a dial around service.
(¶136)

29. For example, a Sprint subscriber that experiments by utilizing a dial-around carrier for the majority of its minutes of use in a given month and then ceases using the dial-around service is counted as having switched major vendors in a given month, and then is counted as switching back to Sprint in the subsequent month. Such a customer would be counted as switching vendors twice, despite the fact that it would not have changed its presubscribed long distance carrier over this period. Using this approach, Drs. Besen and Brenner consider a consumer to have switched vendors even if the same carrier receives the largest payments from the consumer in consecutive months. This is because Drs. Besen and Brenner define a consumer's "main vendor" based on minutes of use, not dollar spending.

30. Although the tabulations presented by Drs. Besen and Brenner's appear to be heavily influenced by including dial-around carriers as a residential customer's "main vendor," they do not show that dial-around vendors present a significant competitive constraint on the pricing of branded carriers.

- Available data confirm that the approach taken by Drs. Besen and Brenner exaggerates the competitive significance of fringe long distance carriers and dial-around suppliers. Drs. Besen and Brenner report that fringe and dial-around firms were the "main vendor" for fully 20.4 percent of the households in the sample. This share, however, is far greater than the number that use a fringe supplier as their

presubscribed carrier. For example, the Paragren data used in our February affidavit indicate that as an average for the period between October 1998 and September 1999, fringe firms were the presubscribed carriers for 10.2 percent of residential customers and accounted for 8.8 percent of long-distance spending by residential consumers. Dial-around services accounted for another 3.0 percent of spending by residential consumers. Thus, the share of households that have a fringe supplier as their "main vendor," as identified by Drs. Besen and Brenner, is roughly twice as large as their share based on revenue.

- Dial-around services are unlikely to be a significant competitive consideration if consumers quickly switch back to their presubscribed carriers after a period of experimentation with a dial-around carrier. In fact, available data suggest that residential consumers that experiment with fringe and dial-around carriers switch back to name brand carriers. Drs. Besen and Brenner estimate that "about 36 percent of households in the sample for 12 months used an emerging carrier as their main vendor for one month within that time." However, the Paragren data reported in our February declaration indicate that the share of residential households with non-brand name suppliers as their presubscribed carrier grew only modestly from October 1998 through September 1999, from 8.9 percent to 10.0 percent between October 1998 and September 1999.²⁵ Moreover, the Paragren data indicate that the share of total long distance spending on dial-around carriers actually fell over this period, from 3.5 percent in October 1998 to 2.9 percent September 1999.

25. This calculation excludes GTE, which as the incumbent local exchange carrier would have significant brand name recognition among its in-region customers. If GTE is not considered a brand name supplier, the share of residential consumers served by fringe suppliers grew from 9.7 to 11.2 percent over this period. Other ILECs, such as SNET and ALLTEL, which provide long distance service to their in-region customers are not separately identified in the underlying data.

- Drs. Besen and Brenner do not report the sensitivity of their results to modifications in their approach to measuring customer churn.²⁶ For example, they do not attempt to reconcile their results with those presented in our February declaration by using their data to compare results based on a customer's (i) "main vendor" and (ii) presubscribed carrier. As noted above, we analyzed customer switching behavior based on their presubscribed carrier, as identified by Paragren Technologies in the underlying data.

31. In sum, the switching data analysis performed by Drs. Besen and Brenner is based on a flawed approach to identifying when a customer switches to a non-branded carrier. However, if their analysis suggests that consumers are willing to switch to fringe and dial-around suppliers, it also implies that consumers are dissatisfied with these services and switch back to brand name suppliers with high frequency. This analysis, therefore, does not support Drs. Besen and Brenner's suggestion that fringe suppliers would constrain the pricing of branded carriers if MCI WorldCom and Sprint were to merge.

V. CRITICISMS OF THE ANALYSIS OF STOCK MARKET RESPONSE TO THE PROPOSED TRANSACTION ARE BASELESS

32. Our February declaration showed that the stock prices of long distance carriers that compete with MCI WorldCom and Sprint rose significantly in the two days following the announcement that the firms reached a merger agreement.²⁷ This results suggests that investors believed that the transaction would adversely affect competition by enabling rival long distance carriers to raise price. In their reply declaration, Frederick Warren-Boulton and Serdar Dalkir claim that our analysis is "fundamentally flawed" for two reasons:

26. We note that their approach differs from the methodology used by Paragren Technologies to identify a respondent's principal long distance carrier. Paragren classifies subscribers based on the PICC reported in its survey and identifies PICC changes based on this information.

27. Our analysis also showed that similar results are obtained if a three day window is used to evaluate the effect of the merger.

First, the effect of this merger cannot be reliably evaluated using the event “window” – October 5 and 6 -- employed by Drs. Carlton and Sider. The assumption behind using that (or any) time period as the event window is that the market’s estimate of the probability of the merger increased substantially during that period. Since October 5 and 6 include the announcement date of the merger – October 5 – this would often be a reasonable assumption. However, once a complete time series for the estimated probability is calculated it is clear that there was no significant “event” during the period analyzed by Drs. Carlton and Sider. [...]

Second, even if the two day window chosen by Carlton and Sider were a meaningful period for study, they failed to hold constant for the effects of other significant events that occurred during that period (e.g., changes in the probability of the AT&T-MediaOne merger) and that had a separate and major effect on the stock price of AT&T.

33. Instead of performing an “event study” in which the response of stock prices to discernible events is analyzed, Drs. Warren-Boulton and Dalkir perform an alternative analysis which attempts to relate changes in stock prices to changes in the probability that a transaction will be completed. They claim that their approach improves upon the standard event study methodology which, as they recognize, can understate estimates of investors’ expectations about the competitive effects of a merger. For example, if investors believe that the proposed transaction will raise long distance prices but there is only a 50/50 chance the transaction ultimately will be completed, then the announcement of the transaction will cause the stock price of rivals to be bid up less than if investors believed that the (anticompetitive) transaction would proceed with certainty.

34. There are two implications of the critique of our analysis presented by Drs. Warren-Boulton and Dalkir.

35. First, their comments imply that our analysis, which finds that announcement of the proposed transaction had a significant positive effect on the stock price of rivals (which is consistent with an anticompetitive outcome) understates the effect that would have been observed if investors believed that the transaction were certain to be completed. Drs. Warren-Boulton and Dalkir claim that investors’ actions indicate that the likelihood that Sprint and MCI WorldCom would successfully merge increased by only 10 percent during the event window we

analyzed.²⁸ This, however, suggests that the estimated change in rivals' stock prices understates by a factor of 10 the market's assessment of the anticompetitive effect that would result if the transaction was certain to succeed. It is also important to note that Drs. Warren-Boulton and Dalkir do not identify any intervening events that might suggest that the observed increase in stock prices of rival long distance companies during the two-day window we analyzed was due to factors other than an increase in the probability of a merger between Sprint and MCI WorldCom.²⁹

36. Second, Drs. Warren-Boulton and Dalkir claim that their alternative model would give more precise estimates of the market's reaction to the proposed transaction. This claim, however, presumes the availability of accurate measures of the probability that the proposed transaction will be completed. The alternative analysis presented by Drs. Warren-Boulton and Dalkir, however, is not based on accurate probability measures.

37. Drs. Warren-Boulton and Dalkir attempt to estimate the probability that the proposed transaction will be completed based on information on: (i) the acquisition price for Sprint stock in the merger agreement; (ii) estimates of what Sprint stock would have traded for in the absence of the bid; and (iii) the actual price of Sprint stock. The probabilities are estimated for periods both before and after the transaction was announced. Their analysis attempts to account for other changes in industry conditions during their period of analysis.

38. Drs. Warren-Boulton and Dalkir, however, make a basic error in estimating the probability that an acquisition of Sprint by MCI WorldCom would be completed. Specifically, their methodology ignores the fact that there were multiple bidders for Sprint -- MCI WorldCom and BellSouth. Even if Drs. Warren-Boulton and Dalkir's methods accurately approximated the

28. Warren-Boulton and Dalkir, pp. 7-8.

29. Although Drs. Warren-Boulton and Dalkir allude to changes in the market's assessment of the likelihood that the AT&T/MediaOne merger would be approved over this period, they provide no evidence that there was any news that would this probability over the October 5-6 period. As discussed below, Drs. Warren-Boulton and Dalkir may have incorrectly interpreted changes in AT&T price over this period to changes in the likelihood of the AT&T/MediaOne merger instead of a response to announcement of the Sprint / MCI WorldCom transaction.

probability that Sprint will be acquired, their estimates do not distinguish between the probability it would be acquired by MCI WorldCom or BellSouth.³⁰

39. To demonstrate this error, consider a hypothetical example in which 10 firms are bidding to acquire a company. Further assume that the market correctly anticipates the acquisition price but cannot anticipate which firm will win the bidding. In this circumstance, announcement of the transaction may not affect the price of the target's stock and thus may not affect Warren-Boulton and Dalkir's estimates of the probability that the transaction would be completed. Nonetheless, on the day the transaction is announced, there will be a large increase in the probability that a deal will be completed for the winning bidder and a large decrease in the probability that a deal will be completed with any of the nine losing bidders. Therefore, even if there is no change in the probability that the target company, such as Sprint, will be acquired, it would be incorrect to infer that there was no change in the probability that a particular transaction, such as an acquisition by MCI WorldCom, would take place.

40. The modest change from October 4 to October 6 in the probability that the proposed transaction will be completed calculated by Drs. Warren-Boulton and Dalkir does not solely reflect the change in the probability that a transaction involving MCI WorldCom will be completed. It was not known until before trading on October 5 whether MCI WorldCom or BellSouth would win this competition. The identity of the winner, however, would have far different implications with respect to competition in the provision of long distance service. A merger agreement between BellSouth and Sprint would have been a "vertical" transaction between a regional local exchange carrier and a long distance carrier and would not have increased the concentration of long distance services. In contrast, the proposed transaction

30. Drs. Warren-Boulton and Dalkir claim that the probability that Sprint would be acquired increased from roughly 0 to 47 percent between September 15 and October 4, and from roughly 47 percent to 57 percent on October 4-6. (Warren-Boulton and Dalkir, Figure 1.) These calculations, however, do not relate solely to the probability that a transaction involving MCI WorldCom and Sprint would occur; they equally would reflect the probability that a transaction involving BellSouth and Sprint would occur.

raises concentration in the provision of long distance services and raises concerns about increasing long distance prices that investors would evaluate.

41. Given these circumstances, the claim by Drs. Warren-Boulton and Dalkir that “there was no significant event during the [October 5 and 6] period analyzed by Drs. Carlton and Sider” simply is incorrect. Even if there was no change in the probability that Sprint would be acquired, there was a major change in the probability of MCI WorldCom acquiring Sprint. Changes in the stock prices of rival long distance companies on October 5 and 6 responded to that new information. As noted above, Drs. Warren-Boulton and Dalkir identify no other events during this period suggesting that the stock price movements of rival long distance companies was due to other factors. The use of longer time periods to evaluate changes in stock prices of rivals to this new information will inevitably confuse estimation the effect of the impact of this new information on rivals’ stock prices with unrelated factors.

42. The large volume of trading in Sprint stock on these days demonstrates that investors were reacting to new information on October 5 and 6. As noted in our February report, trading volume for Sprint stock was extraordinarily high over this period, with an average of 15 million shares traded each day, compared to an average of roughly 2 million shares traded per day during the prior year.³¹ Even though Sprint’s stock price increased only about 10 percent over these two days, the market learned the identity of the merger partner – MCI WorldCom instead of Bell South. As discussed above, this is the information that is key to identifying investors’ assessments of the competitive impact of the proposed transaction. As noted above, if investors had perceived that the MCI WorldCom/Sprint transaction was certain to be completed, then even larger increases in the stock prices of their rivals would have been observed.

31. Trading was also much heavier than normal for BellSouth and MCI WorldCom on those days, suggesting that investors were responding to information about the effect of the merger announcement on each of these firms.

43. The return of Sprint trading volumes to more typical levels after this period suggests that the market responded to the announcement of the proposed transaction. The use of a longer event window under these circumstances would result in combining the response of the proposed transaction with subsequent events. As noted above, Drs. Warren-Boulton and Dalkir do not identify any events unrelated to the merger on October 5 and October 6 that would complicate interpretation of stock price changes of rivals to Sprint and MCI WorldCom.

44. There also appear to be significant econometric problems with the analysis performed by Drs. Warren-Boulton and Dalkir. Although their methodology is very poorly documented, they appear to use information on the price of AT&T stock: (i) in calculating the probability of the AT&T/MediaOne transaction; and (ii) in calculating the probability of the MCI WorldCom/Sprint transaction.³² In turn, both of these probabilities are used to explain changes in the price of AT&T stock following the merger.³³ In this framework, the price of AT&T stock must be treated as an endogenous variable in order to avoid biased coefficient estimates. Drs. Warren-Boulton and Dalkir do not appear to have corrected for this problem in their econometric estimation. As a result, estimates of the impact of their estimate of the probability of the proposed transaction and AT&T's stock price will be biased and inefficient.

45. Drs. Warren-Boulton and Dalkir also suggest that the increase in the price of the stock of certain rivals to MCI WorldCom and Sprint, including Qwest and Global Crossing, may reflect the market's perception that they would become acquisition targets of BellSouth following the rejection of BellSouth's bid rather than investors' expectations about potential anticompetitive consequences of the transaction.

46. Two factors suggest that this hypothesis should be discounted.

- First, Drs. Warren-Boulton and Dalkir do not suggest that the failure of BellSouth's bid would result in an increase in the probability that AT&T would be acquired.

32. Warren-Boulton and Dalkir, footnote 4.

33. Warren-Boulton and Dalkir, p. 10 and footnote 9.

Nonetheless, the price of AT&T stock, like that of Qwest, Global Crossing and Level 3, increased more than expected based on changes in overall market conditions during the October 5-6 period. This suggests that factors other than the “acquisition hypothesis” explain the stock price movement of rivals to MCI WorldCom and Sprint over this period.

- Second, if BellSouth’s bid had succeeded, carriers such as Qwest and Global Crossing may have become the targets of a bid by MCI WorldCom. Drs. Warren-Boulton and Dalkir provide no explanation for why the failure of the BellSouth bid increased the probability that these firms would be acquired relative to this alternative. In the absence of such an explanation, there again is no reason to attribute the stock price movement of rivals to MCI WorldCom and Sprint to the acquisition hypothesis.


CONCLUSIONS

47. Applicants and their economists take issue with various aspects of the findings presented in February declaration. Their comments, however, provide no basis for altering our conclusion that the proposed transaction is likely to adversely affect mass market consumers of long distance services.

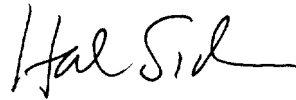
- The growth of new long distance networks, which Applicants claim we have ignored, does not introduce new brand-name suppliers of long distance services to mass market consumers and does not alter the fact that the proposed transaction merges two of only three such long distance carriers.
- Trends in AT&T’s long distance pricing in recent years as well as the level of price charged by AT&T are inconsistent with claims by Applicants and their economists that fringe carriers constrain prices charged by the brand name carriers to the competitive level.

- Claims by Applicants' economists that consumers frequently utilize non-brand name carriers fails to distinguish consumer experimentation with dial-around carriers with willingness to make permanent changes in their long distance supplier and fail even to identify a consumer's "main vendor" based on expenditures. They fail to show that dial-around carriers constrain prices charged by brand-name carriers.
- The analysis by Applicants' economists implies that our stock price analysis, which finds that investors expected the proposed transaction to have an anticompetitive outcome, understates the magnitude of these expectations. The alternative methodology that they proposed is based on a flawed assessment of the probability that Sprint would merge with MCI WorldCom instead of another bidder.

We declare under penalty of perjury that the foregoing is true and correct to the best of our knowledge and belief.



Dennis W. Carlton



Hal S. Sider

May 10, 2000

Appendix I

Access Charges and USF Components

Date	Per Minute Access Charges	PICC	Fixed USF Contribution	Variable USF Contribution	Access Charge Per Minute Evaluated at:				
					15 Minutes	60 Minutes	120 Minutes	300 Minutes	600 Minutes
January-1991	0.0718		0.3289		0.0937	0.0773	0.0745	0.0729	0.0723
February-1997	0.0604		0.5371		0.0962	0.0694	0.0649	0.0622	0.0613
November-1998	0.0382	0.49		3.93%	0.0854	0.0523	0.0474	0.0442	0.0430

Source: FCC, "Trends in Telephone Services"; "Joint Monitoring Reports".

Ex Parte Declaration of Professor Jerry A. Hausman

1. My name is Jerry A. Hausman. I am MacDonald Professor of Economics at the Massachusetts Institute of Technology in Cambridge, Massachusetts, 02139. I previously submitted a declaration in this proceeding. Here I reply to various claims put forward in the declarations submitted by Drs. Besen and Brenner and Dr. Kelley and Mr. O'Dwyer as they relate to the declaration I prepared and submitted on behalf of SBC Communications Inc. in opposition to the merger of MCI WorldCom and Sprint.

I. Drs. Besen and Brenner on Long Distance Competition

2. In their response to my declaration, Drs. Besen and Brenner focus on the amount of capacity in various firms' long distance networks (pp. 1-3). Their argument is that significant new capacity exists and that any attempts by MCI WorldCom/Sprint to raise price would be defeated by customers shifting to new firms with abundant capacity. This argument fundamentally ignores market realities in several important respects. First, despite the amount of capacity many of the new entrants possess, none of the new entrants has obtained a share of long distance services of more than a few percent. Certainly, something more than mere capacity is necessary for firms to obtain significant market share and provide a significant competitive effect.

3. Second, Drs. Besen and Brenner offer no econometric evidence to rebut my contention that brands matter in long distance services, particularly in the mass market segment. Though they critique the econometric evidence that I presented, they do not provide any of their own. If, as Drs. Besen and Brenner contend, price and capacity were all that mattered, Excel would have a much greater share than AT&T, yet that is far

from the case. Approximately 80%-90% of AT&T's customers would have lower monthly bills than if they used Excel.

4. Third, if price and capacity were all that mattered and mass market long distance were actually an undifferentiated, unbranded product, it would not be in MCI WorldCom's best economic interests to spend advertising money on Michael Jordan. At most MCI WorldCom would employ an informative advertising campaign simply listing the prices it offers. Drs. Besen and Brenner question whether advertising is used to differentiate long distance brands (pp. 36ff). Of course, if MCI WorldCom and Sprint believed what their economists say, they would not spend the money to pay for high profile spokespeople (such as Michael Jordan and Candace Bergen) when a lower cost spokesperson could deliver the same information.

5. Rather than debate the importance of differentiation versus information, we can analyze the issue empirically. If brand differentiation did not matter, the cross price elasticities between MCI WorldCom and the generic carriers should be extremely high. (That is, a small price difference should lead to a large quantity response.¹) While Drs. Besen and Brenner present no cross price elasticity estimates, my estimates in Table 1 demonstrate that, contrary to Dr. Besen and Brenner's theory, changes in MCI WorldCom's and Sprint's prices have the largest effect on each other's quantities. Thus, the cross price elasticity estimates demonstrate that brand differentiation is important in mass market long distance. In short, the claims of Drs. Besen and Brenner that new carriers constrain the ability of a post-merger MCI WorldCom/Sprint to raise prices,

¹ For an undifferentiated product where brand is unimportant, e.g., a given grade of cement, price differences cannot last for long because customers will switch from the higher price supplier to the lower price supplier.

which are based on no empirical analysis of prices in mass market long distance services, are inconsistent with the market.

6. As set forth in my initial declaration, this merger violates the Merger Guidelines by increasing concentration beyond permitted levels in multiple telecommunications services markets. In long distance services, this marked increase in concentration is true whether one views long distance services as a branded and differentiated product (as I do, at least with respect to the mass market segment) or as an undifferentiated product in which brands do not matter. If long distance services are viewed as a differentiated product market, there can be no question that this merger would create a duopoly of AT&T and MCI WorldCom, and the existence of other firms without widespread brand recognition would not restrain the increased market power the remaining two firms would possess. (The adverse impact on competition would be heightened because of the elimination of Sprint, which has been a pricing innovator, as I discussed in my first declaration (¶¶ 30-31).)

7. Drs. Besen and Brenner contend that brands do not matter and that the handful of facilities-based providers with alternative nation-wide networks and abundant capacity and the hundreds of other firms (mostly resellers) could constrain the ability of AT&T and MCI WorldCom/Sprint to raise prices. If Drs. Besen and Brenner were correct, then the Commission should allow a combination of AT&T, MCI WorldCom and Sprint because the new carriers would continue to constrain any attempted price increase. Even MCI WorldCom's general counsel agreed at the recent FCC Common Carrier Bureau public forum that such a transaction should not be approved. What he did not recognize, however, is that the purported justification for this transaction – the capacity of new

entrants and the potential entry of BOCs into long distance – would apply to the hypothetical merger with AT&T just as much as to this proposed merger.

8. Drs. Besen and Brenner raise some specific criticisms of my econometric analysis, but none of those criticisms has merit and none changes the fundamental conclusion that the merger of MCI WorldCom and Sprint is likely to lead to significant price increases for mass market long distance services. Drs. Besen and Brenner state that my estimated demand elasticity for AT&T is not high enough (p. 4, pp. 50-51). Even if my estimated demand elasticity for AT&T (-1.12) is somewhat low, as Drs. Besen and Brenner claim, it clearly is not far off. Indeed, my estimate would need to be only about 10% higher (-1.22) to be in accord with likely AT&T markups over marginal costs. Furthermore, AT&T has many brand loyal customers and the reported model estimate for demand elasticity is for the mean (average) customer elasticity. Prices and markups over marginal costs, of course, are set by marginal (not average) customer responses.² Most importantly, Drs. Besen and Brenner do not question my estimated demand elasticities for MCI (-1.33) and for Sprint (-1.81). The estimated demand elasticity for AT&T does not affect the analysis of price changes (to the first order) for MCI WorldCom and Sprint due to the merger. Thus, my estimates of the likely price increases of 5.4% for MCI WorldCom customers and 8.9% for Sprint customers are not significantly affected by the estimated AT&T elasticity.³ To demonstrate this point, I changed the AT&T price elasticity to a value of -1.33, the same as that estimated for MCI WorldCom, and found

² For the average AT&T customer, who will not be on a discount plan, an elasticity of about -1.2 is consistent with likely markups over marginal cost.

³ This statement of the absence of a first order effect from AT&T is demonstrated in J. Hausman, G. Leonard & D. Zona, "Competitive Analysis with Differentiated Products,"